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Federal-State Joint Board on Universal Service;	)	CC Docket No. 96-45
Comments on the Rural Task Force Recommendation	)	FCC-00J-3

COMMENTS OF THE VIRGIN ISLANDS TELEPHONE CORPORATION

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SUMMARY

Vitelco applauds the efforts of the Rural Task Force ("RTF") to develop an appropriate mechanism to provide universal service support to rural and insular carriers. The RTF's recommendations are the result of careful deliberations that considered the views of representatives from state public utility commissions, state consumer advocates, local exchange carriers, and long distance carriers. Although these recommendations are not all that Vitelco feels is warranted, on balance, the RTF's mechanism is far better than the existing system, which fails to satisfy the statutory requirement of Section 254 of the Communications Act to provide "sufficient" support. Thus, Vitelco urges the Federal-State Joint Board ("Joint Board") to take expedient action on RTF's recommendations to ensure that all Americans, no matter where they live, continue to enjoy access to affordable, reliable, and modern telecommunications services.

Insular Differences Matter. In Section 254(b), Congress specifically provided that the universal service mechanism should provide support to rural, *insular* and high-cost areas. By including each of these categories separately, Congress required that no region would be permitted to fall through the cracks of the new law. The Commission, Joint Board and the RTF all recognize that the Act requires the unique status of insular carriers to be explicitly addressed.

Insular areas are different. The RTF found that insular carriers face higher costs to build and maintain plant, higher labor costs, increased costs of project management, and higher operational costs. This conclusion is supported by a special report by Dr. Kenneth Gordon which found that geographic isolation, and their topography and geology combine to increase costs.

The geographic isolation of insular areas leads to much higher unit transportation costs than similar mainland communities experience. The small size of insular economies limits both the available production capacity and the market available to local businesses, with no benefits of

economies of scale. Additionally, while tropical climates are a kind of paradise, that is not the case if you are a provider of telecommunications services. The carrier must overcome a rough, rugged terrain, a warm, moist tropical climate, a high level of corrosive airborne salt, and very destructive weather patterns. Moreover, the same conditions that make providing telecommunications expensive, also combine to create generally difficult economic conditions. The bottom line is that the unique geographical, geological, and climatological conditions found in insular areas causes carriers in these areas to experience higher costs than carriers on the mainland. These costs and economic factors combine to yield a telephone penetration rate in the U.S. Virgin Islands lower than that of the rest of the country.

Historic Costs, Not Hypothetical Models Must Be Used. Vitelco is adamant that the calculation of universal service support be based on rural carriers' actual historic costs, rather than a hypothetical forward-looking economic costs ("FLEC") model. As an initial matter, there is no evidence that insular areas should receive less compensation than has previously been granted under the older universal service cost mechanism. Indeed, the record evidence developed by the RTF suggests that insular carriers may require increased levels of support. Insular carriers face higher costs in weaker economies.

National hypothetical FLEC models are particularly inappropriate with respect to insular carriers because these models have been developed to serve "mainstream" carriers. The U.S. Virgin Islands, due to the small size of its market, will have no opportunity to take advantage of averaging that would ameliorate the widely inconsistent results of a model.

Nor does the FLEC model satisfy Section 254's requirement to support the deployment of advanced services, again because the present model's assumptions are based on choices optimized for conditions on the mainland. As a result, it fails to reflect the constraints that

insular carriers face in selecting, constructing, and maintaining an infrastructure suited to their unique situations.

The Non-Rural Mechanism Fails To Provide Sufficient Support. The RTF's conclusion that the non-rural method and Synthesis Model are not the appropriate tool and application for rural and insular carriers is clearly correct. For one, this model has never been shown to be reliable when applied to insular areas. When it developed the model, the Commission did not test it using data from the U.S. Virgin Islands because it was not available. The same is true now. The RTF did not employ a broad base of insular areas data because such data were unavailable. Moreover, its tests of the model using rural data were a disaster: the FCC's model would result in a *$1.102 billion decrease* in funding. The results are hardly surprising. Because the FLEC-based model fails to deal with the reality of the unique characteristics of insular areas, it fails to meet the requirements of Section 254.

The results of the RTF's study also illustrate that the use of the non-rural national benchmark would seriously underfund the required universal service support for rural carriers. Use of the current benchmark resulted in a $1 billion decrease in total universal service support. The problem is that the non-rural model simply washes out the high cost lines of rural carriers when they are aggregated into the much larger number of lines provided by non-rural carriers. It is clear that simply folding in rural carriers into the non-rural nationwide benchmark will fail to account for statistical anomalies.

In insular markets, many of which continue to experience depressed economic conditions, there is simply less room for error. First, these areas tend to have a precarious economic position at the outset. Moreover, shortfalls cannot be recovered elsewhere. For example, in the U.S. Virgin Islands, *no intrastate toll service exists in the territory to allow the territorial Commission*

to generate additional funding to subsidize high-cost local service. Finally, any additional local funding of universal service would come from the very same people who receive it. By underestimating the cost of providing service, and thus underfunding these carriers, the Commission would be asking what are already some of the poorest regions of the United States to tighten their belts further in order to make up for an error in regulation, a result squarely inconsistent with Section 254.

Long Term Support Is Vital to Insular and Rural Carriers. Vitelco supports the RTF's recommendation to retain the existing Long Term Support ("LTS") mechanism for rural carriers remaining in the National Exchange Carrier Association Pool. The LTS mechanism currently comprises an important part of the total support given to insular carriers. The Commission itself recognized the importance of LTS to the overall universal service mechanism and found that such support is in the public interest. The stark fact is that Vitelco and other insular carriers depend upon LTS to maintain rates at reasonable levels. Such support is necessary to advance the express goals of Section 254.

The Elimination/Reform of Existing Limits on Support Is Required. The Joint Board has an obligation to recommend the elimination or reform of the policies that arbitrarily limit the size of the universal service fund or restrict the ability of insular and rural carriers to recover the costs of providing service. For one, Vitelco supports the RTF's recommendation that the existing cap on the overall size of the high cost fund be significantly modified. The rationale used to adopt the cap in 1993 is nowhere to be found in the express language of Section 254. Recognizing that caps are a necessary policy compromise, however, Vitelco supports caps that are rational and reasonable, such as those proposed by the RTF.

On the other hand, limiting the support a carrier can receive on lines it obtains through merger and other types of acquisitions is bad public policy and contrary to Section 254's mandate. This restriction arbitrarily hinders carriers from upgrading the service quality and rollout of advanced telecommunications services, contrary to Section 254's requirements, which even the Commission has recognized. Vitelco urges the Joint Board to eliminate the arbitrary impact on those carriers and customers who are penalized simply by the circumstance of acquisition.

In a similar fashion, the Joint Board must act to eliminate the corporate expense limitation. This provision restricts the ability of carriers to recover legitimate expenses associated with the provision of high cost service. The continued presence of this cap, without reconsideration and review under the record currently developed, is arbitrary.

Finally, the ability of a carrier to recover "stranded costs" when it loses lines to a competitor is necessary. After all, these costs are a direct result of the regulatory pact that required carriers to serve all customers in an exchange in return for the constitutionally mandated promise that carriers get an opportunity to earn a fair return on their assets. The costs associated with that pact represent real costs that a regulators cannot "leave on the table." Therefore, Vitelco joins the RTF in asking that the issue be raised to the FCC for further examination.

Costs Created by Portability Must Be Recoverable. Vitelco supports the RTF's recommendation to make universal service support for rural carriers available to all eligible telecommunications carriers ("ETC"). However, Vitelco urges the Joint Board to address how rural carriers will be able to recover their actual costs in the event that their universal service support revenues decline as competitive ETCs increase their share of loops. At bottom, rural and insular carriers still need to recover their actual costs in order to maintain sufficient support.

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COMMENTS OF THE VIRGIN ISLANDS TELEPHONE CORPORATION

The Virgin Islands Telephone Corporation ("Vitelco"), by its attorneys, hereby submits these comments in response to the *Public Notice*[1] requesting comment on the recommendations of the Federal-State Joint Board's Rural Task Force ("RTF").[2] Vitelco applauds the efforts of the RTF and urges the Federal-State Joint Board ("Joint Board") to take expedient action on those recommendations. Simply put, the present system of support simply does not satisfy the statutory requirements of Section 254 of the Communications Act to provide "sufficient" support. Therefore, immediate action is required to ensure that all Americans, no matter where they live, will continue to enjoy access to affordable, reliable, and modern telecommunications services.

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[1] *Federal-State Joint Board on Universal Service Seeks Comment on the Rural Task Force Recommendation*, CC Docket No. 96-45, FCC-00-J-3 (Oct. 4, 2000) ("*Public Notice*").

[2] *Federal-State Joint Board on Universal Service, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 (Sept. 29, 2000) ("*RTF Recommendation*").

I. INTRODUCTION

The RTF was formed by the Federal-State Joint Board to examine the issue of universal service support to carriers serving rural and insular areas. It was specifically tasked to present to the Joint Board recommendations on the appropriate mechanism to be used in reforming universal service support for rural carriers. With considerable foresight, RTF membership included representatives from state public utility commissions, state consumer advocates, local exchange carriers, and long distance carriers. In this way, the Joint Board guaranteed that RTF deliberations would consider all points of view. Additionally, such membership would ensure that any recommendations coming out of this body would reflect a broad consensus.

Vitelco is encouraged by the work of the RTF. This group has constructed "a delicately-crafted package"[3] that carefully considers the interests of a very diverse body of interested parties. The RTF engaged in considerable deliberations and significant study (including the publication of several different white papers on key issues). After two years of work, now it is time for the Joint Board to act. Although they are not all that Vitelco feels is warranted, on balance, the recommendations are better than the existing system and should be adopted. There are serious problems with the existing mechanism of supporting the provisioning of telecommunications services to customers in high cost rural and insular areas. These problems undermine the ability of carriers to provide services and fail to satisfy the statutory mandate to provide "sufficient" universal service support. For example, current policy, contrary to statute, places undue weight on limiting the amount of universal service support through caps and other mechanisms. Also, counter to the statute, the existing mechanism treats rural and insular

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[3] *RTF Recommendation* at 3.

carriers, in many respects, like non-rural carriers. Such limits have profound negative effects on insular and rural carriers.

For the reasons discussed below, Vitelco urges the Joint Board to move quickly to adopt the recommendations made by the RTF.

II. THE ACT INTENDED THAT INSULAR AREAS RECEIVE SPECIAL TREATMENT REGARDLESS OF THE RURAL OR HIGH COST NATURE OF THE INSULAR AREA.

A. Section 254(b) Specifically Charges the FCC with Ensuring that Americans in Rural, High Cost and Insular Areas Enjoy Universal Services.

When it enacted the 1996 Act, Congress included section 254(a)(1), which "directed the Commission to establish support mechanisms for the preservation and advancement of universal service in the competitive telecommunications environment that Congress envisioned."[4] In section 254(b), Congress specifically provided that the universal service mechanism should provide reasonably comparable rates in "rural, *insular* and high-cost" areas.[5] By including each of these categories separately, Congress was acting to ensure that no region fell through the cracks of the new law. Congress' addition of "insular" to the list of categories in the statute clearly indicates that the unique characteristics of insular regions should be recognized irrespective of those regions' high-cost or rural status. As a matter of statutory construction, the use of different terms in the statute makes clear Congress intended that the Commission specifically address universal service protections for insular areas separate and apart from those

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[4] *Federal-State Joint Board on Universal Service,* 14 FCC Rcd 20432, 20442 (1999)(Ninth Report and Order and Eighteenth Order on Reconsideration) ("*Ninth Report and Order*").

[5] 47 U.S.C. § 254(b)(3) (emphasis added). The conference report accompanying the 1996 Act reveals that Congress deliberately extended universal service support to insular areas to provide consumers in such areas "access to telecommunications and information services." H.R. Conf. Rep. No. 104-458, at 131 (1996), *reprinted in* 1996 U.S.C.C.A.N. 124, 142.

that are applicable to other high-cost areas. As courts have noted, "[w]here different terms are used in a single piece of legislation, the court must presume that Congress intended the terms to have different meanings."[6] While agencies have great discretion in interpreting statutory text, they may not disregard the intent of Congress. "If the intent of Congress is clear, that is the end of the matter."[7]

Here, both the language of section 254 and the legislative history clearly indicate that Congress clearly wanted the Commission to recognize that insular areas are subject to their own set of unique challenges when it comes to the provision of universal telecommunications service. Indeed, in 1996, the Joint Board issued a recommended decision that identified this need to accord special attention to the circumstances of insular carriers. That decision "recognize[d] the special circumstances faced by carriers and consumers in the insular areas of the United States."[8] As a result, the Joint Board advised that the Commission adopt an approach, different from that used in other areas, whereby "rural carriers serving high cost insular areas . . . should continue to receive universal service support based on their embedded costs."[9]

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[6] *Transbrasil S.A. Linhas Aereas v. Dep't of Transportation*, 791 F.2d 202, 205 (D.C. Cir. 1986) (quoting *Wilson v. Turnage,* 750 F.2d 1086, 1091 (D.C. Cir. 1984), *vacated on other grounds*, 755 F.2d 967 (D.C. Cir. 1985)).

[7] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 842 (1984).

[8] *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 87, 308 (1996) (Recommended Decision).

[9] *Id.* at 308. To date, the FCC has not acted upon this unanimous recommendation of the Joint Board.

B. The Federal-State Joint Board Recommended that Insular Companies Be Accorded a Special Status Because of Their Insular Status.

The RTF recognized that the 1996 Act requires the unique status of insular carriers to be explicitly addressed by the Joint Board and the Commission.[10] Although primarily focused on identifying the necessary distinction between universal service support for rural and non-rural carriers, the RTF did find that insular carriers must face higher costs to build and maintain plant, higher labor costs, increased costs of project management, and higher operational costs.[11] The RTF specifically recognized that insular carriers "experience difficulty and high cost in moving personnel, equipment and supplies to remote and insular communities."[12] Further, its recognition that coral and volcanic rock surface conditions "require expensive specialized outside plant construction practices" is attributable to the geographic conditions facing insular, as opposed to non-insular rural, carriers.[13] Additionally, the RTF recognized that the inhospitable weather conditions – particularly frequent tropical storms and hurricanes – raise both construction and operations costs.[14] In particular, the RTF commented that "[r]ecent experience with hurricanes in the Virgin Islands seems to indicate that with the current frequency of these severe natural disasters, plant service lives may be better measured in months instead of years."[15] In sum, it recognized, like Congress and the Commission before it, that "'rural telephone companies' . . . including carriers serving insular areas, are different in terms of the costs they face and the

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10 *See, e.g., RTF Recommendation* at 5-7, 14.

11 *See* Rural Task Force, *White Paper 2: The Rural Difference*, 26-29 (Jan. 2000), *available at* <http://www.wutc.wa.gov/rtf> ("*The Rural Difference*").

12 *See RTF Recommendation* at 12.

13 *Id.*

14 *See The Rural Difference* at 29.

15 *Id.*

territories they serve," and thus the universal service support must be carefully tailored to address the special circumstances of rural and insular carriers.[16]

Accordingly, the Commission should follow the RTF's *Recommendation* and adopt a USF methodology that distinguishes insular carriers, such as Vitelco, from other carriers that are dissimilarly situated. Vitelco urges the Commission to: (i) recognize the special status of insular carriers, and (ii) adopt a USF methodology that would permit the federal government to continue to *fully* fund universal service in insular areas.

III. INSULAR AREAS EXPERIENCE UNIQUE CHALLENGES TO PROVIDING UNIVERSAL SERVICE.

Evidence other than that presented in the RTF white papers supports the unique challenges in serving insular areas. Carriers serving insular areas face circumstances that have the effect of driving up their costs of providing services to customers. These characteristics are directly tied to the very nature of insular areas – their geographic isolation, and their topography and geology. Dr. Kenneth Gordon, Vice President of National Economic Research Associates, Inc. ("NERA") and former Chairman of the Massachusetts Department of Public Utilities and the Maine Public Utilities Commission, has prepared comments that describe in detail insular carrier service issues. Dr. Gordon's comments provide empirical support for Vitelco's comments and are discussed below and included with this filing as Appendix A.[17]

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16 *Id.* at 5; *see also RTF Recommendation* at 12.

17 *See* Comments of Dr. Kenneth Gordon, CC Docket No. 96-45 (filed Dec. 17, 1999) ("Gordon Comments") (attached as Appendix A).

A. Insular Areas Are Isolated Geographically, Which Makes Costs Higher.

The geographic isolation of insular areas is a significant factor that causes carriers in insular areas to experience far higher costs than carriers in the continental United States. As Dr. Gordon fully explores in his comments, there are several economic reasons for this higher cost burden on insular carriers.

Higher Unit Transport Costs. Island communities suffer from much higher unit transport costs than similar communities located on the mainland.[18] These higher transport costs, in turn, are attributable to three primary factors: (1) remoteness; (2) the imbalance of trade; and (3) the lack of economies of scale.

- ***Remoteness***: Transport costs increase rapidly the farther an island is from the mainland because of the increased distance that material must be transported either by sea or air.[19] The U.S. Virgin Islands are located in the middle of the Caribbean Sea, 1,200 miles distant from the coast of Florida. This long distance, combined with "less advanced and more uncertain regular transport technologies" between the mainland and the U.S. Virgin Islands, lead to high transport costs and increased likelihood of delays, which further add to costs.[20]

- ***Imbalance of Trade***: Transport costs to insular communities are also increased by the fact that these communities are net importers of goods, which causes an imbalance between the inbound and outbound movements of goods. The under-utilization of outbound transport from island communities has a deleterious impact on the unit costs for inbound flows. "The end

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18 *See id.* at 4-6.

19 *See id.* at 6.

20 *Id.*

result is higher unit transport costs because[,] since containers often leave with few goods[,] the high opportunity costs of such trips will be reflected in higher inbound unit freight rates."[21]

- ***Lack of Economies of Scale***: Furthermore, because of their size and concurrent small market sizes, small islands simply do not import or export sufficient volumes of goods to achieve economies of scale. As a result, unit transport costs are high. In addition, island communities are too small to take advantage of advances in bulk cargo carriage (such as the development of larger aircraft and container ships) that have led to reductions in freight costs on other, more heavily trafficked, routes.[22] As Dr. Gordon notes, "newer transport technologies that make it possible to transport greater volumes of goods . . . have marginalized small island economies because these economies are too small to justify the high start-up costs involved with using these newer technologies."[23]

The impact of high unit transport costs on the U.S. Virgin Islands is substantial: A review of Vitelco work orders shows that every dollar of material used in operations incurs a transportation cost of $1.10, which more than doubles the effective cost of the equipment.[24]

Higher Costs Arising from the Small Size of Insular Economies. The small size of insular economies limits both the available production capacity and the market available to local businesses for their services. The result is that these economies are too small to be self-sustaining and are dependent upon the import of resources from the continental United States.

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21 *Id.* at 5.

22 *See id.* at 4-5.

23 *Id.* at 5.

24 *See id.* at 18.

Furthermore, insular economies are too small to achieve economies of scale, which results in higher costs.

- ***Non-Self-Sustaining Economies.*** Island economies are too small to allow specialized production of the wide range of goods necessary to meet demand. As a result, they must import a vast range of raw and finished materials, as well as specialized labor, that the community is too small to maintain or provide itself.[25] As described above, this entails significant transportation costs, raising the cost of many goods to businesses operating in insular markets. Thus, the costs of even the most essential and basic of items is driven up. These higher costs ripple through the economy as the imported, expensive raw materials are converted into finished goods. Moreover, the lack of specialized skilled labor requires businesses to import trained personnel from the mainland, and to compete for these personnel with businesses elsewhere in the United States.[26]

The U.S. Virgin Islands community is a prototypical example of a small, isolated non-self-sustaining island community. The entire Islands' population is less than 120,000 people.[27] The Islands lack their own industrial and agricultural bases.[28] The largest industry in the country is tourism, which accounts for over 70% of the territory's GDP. Given the prominence of the tourist industry and the concurrent lack of others, the U.S. Virgin Islands must import the lion's

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[25] *See id.* at 3-4.

[26] *See id.* at 7.

[27] *See* A Report on the State of the Islands 1999, U.S. Department of the Interior, Office of Insular Affairs, 46 (1999) ("Insular Affairs Report").

[28] Total employment in manufacturing was only 2,210 in 1997. *See id.* Even this number is misleading, as many of the jobs in this sector are in export industries such as watch assembly and oil refining. In 1995, the last year for which data is available for agriculture, that sector employed a mere 3,110 of the 45,010 total workforce members. *See id.* at 54.

share of the goods that it uses every year. As a result, the islands suffer from a $400 million a year trade deficit with the mainland. The increased costs of transportation are reflected in the U.S. Virgin Islands' cost of living, which is 30% higher than on the mainland.

- ***Absence of Economies of Scale***. The limited size of insular markets "prevents firms from capturing economies of scale associated with increases in production and thus negatively affects how cheaply goods and services can be produced."[29] This increases the cost of transporting goods and services *within* island communities.[30] Moreover, because of the lack of local demand, infrastructure projects are more costly, often rendering them uneconomical.[31] This leads to reduced levels of investment in infrastructure, which further raises unit costs and hampers economic growth.[32] The U.S. Virgin Islands is no exception; it suffers from an infrastructure that is "not fully developed and is poor in quality" and limits even the ability to provide basic needs such as water and electricity to the Islands' population.[33]

The Impact of Geographic Isolation on Telecommunications Systems. The geographic isolation of insular areas serves to increase the difficulties and cost of providing telecommunications systems, in particular. In the event of an emergency, it is difficult or impossible to rely on rapid importation of spare parts or specialized personnel. For example, even under the best circumstances none of the major shipping firms can offer guaranteed overnight service to the U.S. Virgin Islands; during a crisis, when the airport may be closed,

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29 Gordon Comments at 4.

30 *See id.* at 6.

31 *See id.*

32 *See id.*

33 *Id.* at 6.

delivery times can stretch from many days to even weeks. As a result, insular telephone carriers must stock substantially higher numbers of spares than a rural telephone carrier on the mainland. The same holds true for repair personnel, who cannot easily be brought in from surrounding communities in times of need. The cost of sustaining the necessary extra personnel and inventory is quite significant, which drives up operating costs substantially.

Furthermore, an insular carrier must be prepared to compensate for failures in other areas of infrastructure, as well. Where a mainland telephone carrier may rely on a certain standard of electrical service and only need to provide backup power for a limited time, for instance, an insular carrier is often confronted with electrical service that is far less reliable. This translates into a need for greater redundancy in backup systems, as well as a need for a longer term operating capability for back up systems. Both of these requirements increase costs.

Finally, in the case of the U.S. Virgin Islands, the population is spread between four small islands, separated by forty miles of ocean. Thus, in order to provide service to all of its customers, Vitelco must use a far more elaborate network than would be required in a mainland community of 120,000 people.

B. Unique Geography and Weather Make It Much More Difficult To Provide Reliable Telephone Service in Insular Areas.

While insular areas in tropic climates might be perceived as a kind of paradise, the reality for telecommunications service is very different. Insular areas, such as the U.S. Virgin Islands, are often formed as the result of volcanic activity, which leads to rough, rugged terrain composed mainly of volcanic rock, with extreme elevation changes over very short distances.[34] The warm, moist tropical climate leads to enhanced need for environmental protection for

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[34] *See id.* at 9.

telecommunications equipment and infrastructure. Exacerbating this problem is the high level of airborne salt, which perpetually blows in from the surrounding ocean and causes rapid corrosion of exterior plant.

Many insular areas lie in the path of very severe weather patterns. The U.S. Virgin Islands are no exception. The territory's location in the Caribbean means that it is frequently hit by hurricanes,[35] which can rapidly and unexpectedly destroy large amounts of the Islands' infrastructure.[36] In fact, in 1999, the Islands suffered a direct hit from Hurricane Lenny, which caused very substantial damage on St. Croix. Hurricane Lenny is the fifth hurricane to smash into the islands in the past ten years. These severe weather conditions led the RTF to conclude that: "Recent experience with hurricanes in the Virgin Islands seems to indicate that with the current frequency of these severe natural disasters, plant service lives may be better measured in months instead of years."[37]

The telecommunications infrastructure in the U.S. Virgin Islands is especially vulnerable because the rocky makeup of the ground generally makes the use of underground or buried cable expensive. A large amount of resources must be devoted to repairing and rebuilding the

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35 NOAA has estimated that, in any given year, there is a greater than 50% probability that the U.S. Virgin Islands will be hit by a hurricane or tropical storm. *See* Christopher W. Landsea, FAQ: Hurricanes, Typhoons and Tropical Cyclones, Part G: Tropical Cyclone Climatology, *at* http://www.aoml.noaa.gov/hrd/tcfaq/tcfaqG.html#G12> (last modified Aug. 9, 2000).

36 When Hurricane Marilyn hit the Virgin Islands in 1995, the Islands encountered maximum sustained winds of 102 mph, which destroyed an estimated 80% of the homes and businesses on St. Thomas and left at least 10,000 people homeless. *See* Edward N. Rappaport, Nat'l Hurricane Ctr., *Preliminary Report on Hurricane Marilyn*, *at* http://www.nhc.noaa.gov/1995marilyn.html (last updated Jan. 17, 1996). Approximately 30% of the houses on St. John were destroyed, and 20-30% of the houses on St. Croix were damaged. *See id.*

37 *The Rural Difference* at 29.

communications network when it suffers damage from these storms, which can happen with alarming frequency.[38]

The outcome of the unique geographical, geological, and climatological conditions that exist in insular areas is that carriers in these areas experience higher costs than carriers on the mainland. Consequently, consumers in insular areas face higher rates than consumers in urban or rural areas on the mainland, even under the existing universal service structure. Customers in the U.S. Virgin Islands pay rates that are substantially higher than the U.S. average: residential rates average $18.55, which is 61% higher than the average U.S. figure for *rural* rates ($11.51),[39] and 31% higher than the U.S. average *urban* rate ($14.20).[40] Business rates are also high. The business line flat fee in the U.S. Virgin Islands is $49.85, which is more than double the U.S. average for rural rates ($21.72)[41] and 42% higher than the U.S. average for urban rates ($34.88).[42]

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[38] Only ten months after Hurricane Marilyn, the Virgin Islands were hit by Hurricane Bertha, which damaged almost 2500 homes on St. Thomas and St. John. *See* Miles B. Lawrence, Nat'l Hurricane Ctr., *Preliminary Report on Hurricane Bertha*, *at* http://www.nhc.noaa.gov/1996bertha.html (last updated Nov. 9, 1996). Two years later, Hurricane Georges caused an additional $50 million in damage to the Islands. *See* John L. Guiney, Nat'l Hurricane Ctr., *Preliminary Report on Hurricane Georges*, *at* http://www.nhc.noaa.gov/1998georges.html (last updated Jan. 5, 1999). The most recent event was Hurricane Lenny, a category 4 storm that slammed into St. Croix on November 16-17, 1999. Damages from this storm have been estimated at $165 million for Puerto Rico and the U.S. Virgin Islands. *See* John L. Guiney, Nat'l Hurricane Ctr., *Preliminary Report on Hurricane Lenny*, *at* http://www.nhc.noaa.gov/1999lenny.html (last modified Mar. 31, 2000).

[39] *See* Common Carrier Bureau, FCC, *Reference Book of Rates, Price Indices and Expenditures for Telephone Service* at 36 (June 1999).

[40] *See id.* at 3.

[41] *See id.* at 36.

[42] *See id.* at 16.

C. Insular Economies Remain Fragile Despite Favorable Economic Conditions in the Continental United States.

The rugged terrain, small land mass, difficult weather, and substantial physical isolation that characterize many insular communities can combine to create very difficult economic conditions. Nowhere is this more true than the U.S. Virgin Islands. Because of the geography of the islands, agriculture is difficult, and the long distance to the mainland make the islands an unattractive location for industry.

As noted above, 70% of the economic activity in the U.S. Virgin Islands comes from tourism, which results in relatively low-paying service jobs. The impact of this situation is reflected by the fact that nearly a third of the Islands' population live below the poverty line.[43] Even those earning above the poverty line are impacted by the costlier standard of living. The per capita income is only approximately $12,000, which is only 80% of the average per capita income of the U.S. mainland.[44]

These economic conditions exist despite the buoyant economy in most of the U.S. While the mainland economy has grown at a healthy rate over the past ten years, "[t]hroughout the 1990s, the Virgin Islands economy has been nearly stagnant."[45] The string of hurricanes that have hit the Islands, coupled with other factors, have had a substantial impact on an already struggling economy. Dr. Gordon reports: "Even tourism—one of the main industries in the Virgin Islands—has fared poorly in the last six years. The civilian labor force, income tax

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[43] Approximately 30% of the Islands' population is below the poverty line. *See* Insular Affairs Report at 46. In the mainland U.S., less than 14% of the population lives below the poverty line.

[44] *See id.*

[45] Gordon Comments at 11.

receipts, the number of tourists, cruise ships, occupancy rates in hotels, the number of hotels, and the total expenditures by tourists have all actually dropped during the last six years."[46] The economic boom that the mainland is enjoying has not reached, and is not likely to reach, the territory in the foreseeable future.

D. As a Result of High Costs and Depressed Economic Conditions, Insular Areas Suffer from Low Telephone Penetration Rates.

The conditions that are created by the characteristics of insular areas are not without their effects. These economic factors combine to yield a telephone penetration rate in the U.S. Virgin Islands of only 88%, as compared to the 94% service rate that the rest of the country enjoys.[47] The Commission has noted that "subscribership levels provide relevant information regarding whether consumers have the means to subscribe to universal service and, thus, represent an important tool in evaluating the affordability of rates,"[48] and that low penetration rates in these areas are largely the result of "income disparity, compounded by the unique challenges these areas face by virtue of their location."[49] In the case of the U.S. Virgin Islands, the low subscribership rates indicate that the local economy is simply not robust enough to prevent a

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[46] *Id.*

[47] In 1995, the Virgin Islands Public Services Commission reported that the penetration rate for telephone service in the territory was 87.8%. *See* Letter from Maria Tankenson Hodge, Legal Counsel of VIPSC, to the FCC (Oct. 12, 1995). No more recent data is available, but based on its own investigation and estimates Vitelco believes that this penetration rate remains accurate today. The penetration rate for the U.S. was 94.0% in July 1995, and 94.1% in November 1999, the most recent month for which data are available. *See Monitoring Report*, CC Docket No. 98-202, at 6-10 (Dec. 1999).

[48] *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8838 (1997) (Report and Order) ("*Universal Service Order*").

[49] *Federal-State Joint Board on Universal Service: Promoting Deployment and Subscribership in Unserved and Underserved Areas, Including Tribal and Insular Areas*, 14 FCC Rcd 21177, 21181 n.23 (1999) (Further Notice of Proposed Rulemaking) ("*Unserved and*

large number of island residents from having to forgo basic telephone service if rates were to increase.

IV. THE COMMISSION SHOULD CONTINUE TO RELY ON ACTUAL HISTORICAL COSTS FOR COMPANIES IN INSULAR AREAS.

Vitelco supports, with reservations, the RTF's recommendation that the Commission adopt a modified embedded cost mechanism for universal service support with respect to rural carriers, rather than the Forward Looking Economic Cost ("FLEC") model adopted for non-rural carriers. Vitelco is adamant that the Commission should continue to base the calculation of universal service support on rural carriers' actual historic costs, rather than a hypothetical FLEC model. The RTF's recommendation is particularly appropriate for insular carriers.

A. There is No Record Evidence that Insular Companies Should Receive Less Compensation than Has Previously Been Granted Under the Existing Universal Service Cost Mechanism.

There is no evidence that insular companies should receive less compensation than has previously been granted under the older universal service cost mechanism. As an initial matter, there is no evidence in the extensive record accumulated by the Commission in the *Unserved and Underserved Areas* rulemaking[50] to suggest that insular carriers are receiving a windfall under the current universal service regime. Further, the extensive record established by the RTF in its *Recommendation* and its series of white papers has yielded no evidence that insular carriers should receive a reduced level of universal service support.

Indeed, the record evidence developed by the RTF strongly suggests that insular carriers may require increased levels of support following the restructuring of the existing support

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Underserved Areas FNPRM").

50 *See generally, Unserved and Underserved Areas FNPRM*, 14 FCC Rcd 21177.

mechanism. In fact, the RTF has recommended that the Commission raise the cap on the High Cost Loop ("HCL") fund, thereby allowing rural carriers to receive an increased level of universal service support.[51]

Further, as indicated in the previous section, in the specific context of the U.S. Virgin Islands, there is specific evidence to support the need for an increased level of universal service support above existing levels. As noted above, the Islands have continued to experience a low penetration rate for telephone service (approximately 88%) that is considerably lower than the nationwide average rate of 94%. Reducing the amount of the support, without solid evidence that such a reduction is required or even suggested, would degrade the progress of universal service in insular areas without proper justification.

B. Companies in Insular Areas Are Much More Susceptible to Inaccurate Cost Support Estimates from Hypothetical Models than Are Larger Companies.

Hypothetical FLEC models are particularly inappropriate with respect to insular carriers, which are subject to cost burdens that are unique to the particular geographical context in which each carrier operates. National hypothetical models have been developed to serve the "mainstream" carriers, not the exceptional circumstances faced by insular carriers. The models cannot accurately reflect and capture the unique geographic factors present in insular areas that greatly impact on costs, and thus would be unlikely to derive an accurate assessment of the necessary level of universal service support.

For instance, the terrain averaging approach adopted by the FCC in the non-rural universal service proceeding will have a disproportionately negative impact on areas like the

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[51] *RTF Recommendation* at 24 & n.46 (noting that re-basing of the cap alone "should result in an increase to the HCL fund of approximately $118.5 million").